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UNITED STATES BANKRUPTCY COURT
EASTERN DISTRICT OF CALIFORNIA

UNITED STATES BANKRUPTCY COURT
EASTERN DISTRICT OF CALIFORNIA
SACRAMENTO DIVISION

In re

Case No. 09-27647-A-7

VOLODYMYR and SVETLANA DUBINSKY,

Debtors.

ASIATECH MANAGEMENT, LLC,

Adv. No. 09-2488

Plaintiff,

vs.

VOLODYMYR and SVETLANA DUBINSKY,

Defendants.

MEMORANDUM

Plaintiff Asiatech Management, LLC, asks that its state court judgment for \$129,234.57 be excepted from the chapter 7 discharge of defendants Volodymyr and Svetlana Dubinsky. That judgment is against Volodmyr Dubinsky ("the defendant") only and is based on his guarantee of a sublease entered into by plaintiff, the sublessor, and Advance Technology Office, LLC, ("ATO") the sublessee. The plaintiff alleges that in order to induce it to enter into the sublease, the defendant gave it a materially false financial statement. See 11 U.S.C. §

1 523(a)(2)(B).

2 At trial, the plaintiff voluntarily dismissed Svetlana
3 Dubinsky.

4 28 U.S.C. §§ 157 and 1334 give this court subject matter
5 jurisdiction to determine this core proceeding. See 28 U.S.C. §
6 157(b)(2)(A), (I), and (O).

7 For the reasons explained below, the court agrees that the
8 state court judgment cannot be discharged by the defendant.

9
10 I

11 The plaintiff leased commercial real property located in
12 Santa Clara, California. No longer needing this property for its
13 own business, the plaintiff decided to sublet it.

14 With the assistance of a real estate broker, the plaintiff
15 located ATO in January 2007 as a potential sublessee for a
16 seventeen-month term commencing on February 1, 2007 and ending on
17 June 29, 2008. The defendant was the president of ATO.

18 ATO was a new company formed to develop a product which
19 would display video on Apple iPods. ATO's management included a
20 former senior executive from Apple. ATO had approximately 20
21 equity investors, including the defendant.

22 In the negotiations between each party's real estate broker,
23 the plaintiff demanded, given the recent formation of ATO, that
24 the defendant guarantee ATO's performance of the sublease. To
25 that end, the plaintiff's broker asked for the defendant's
26 personal financial statement to evaluate his ability to make good
27 on the sublease should ATO default. Because there was another
28 entity negotiating with the plaintiff for the sublease, the

1 plaintiff wanted to select the sublessee most likely to perform
2 the sublease's financial obligations.

3 Coincidentally, in November 2006 the defendant had prepared
4 a personal financial statement in connection with an application
5 for a loan from Bank of America. He offered this statement to
6 the plaintiff.

7 That financial statement was very impressive. Of prime
8 importance to the plaintiff and its broker, it showed that the
9 defendant had bank deposits approaching \$1.7 million, marketable
10 securities of over \$300,000, a gross salary of \$720,000, gross
11 rental income of \$420,000, dividend income of \$420,000, and
12 interest income of \$184,000. In short, the defendant had about
13 \$2.0 million in deposits and securities and gross income from all
14 sources of more than \$1.7 million. On the expense side, the
15 defendant's financial statement reported approximately \$1.0
16 million in annual expenses.

17 While the financial statement also reported more than \$36
18 million in real estate and interests in various businesses and a
19 \$28 million net worth, it was the defendant's liquid assets
20 (approximately \$1.7 million) and his income (approximately \$1.7
21 million and \$700,000 after all annual expenses) that convinced
22 the plaintiff to go forward with the sublease to ATO.

23 The parties signed the sublease at the end of January 2007.
24 It required a monthly rent payment of \$8,299.20. The February
25 rent and a deposit were paid by ATO as was the March rent.

26 ATO's business then failed, apparently because Apple began
27 selling iPods with native video capabilities. ATO paid nothing
28 further and the defendant ignored the plaintiff's demands that he

1 honor his guarantee. When the premises were not voluntarily
2 surrendered, the plaintiff evicted ATO.

3 The plaintiff then filed suit in Santa Clara Superior Court
4 to collect on the defendant's guarantee of the sublease. The
5 defendant answered the complaint but failed to appear for trial.
6 In July 2008, the state court entered its judgment for
7 \$129,234.57 in favor of the plaintiff against both ATO and the
8 defendant. In its attempt to enforce the judgment, it recovered
9 only \$2,465.23 from the defendant's bank accounts.

10 The defendant and his spouse then filed their chapter 7 case
11 on April 22, 2009. Their bankruptcy schedules reported assets of
12 \$1,338,964.47, liabilities of \$15,791,575.58, and household
13 income of \$9,000 a month.

14 In contrast to the bank deposits reported in the November
15 2006 financial statement, the bankruptcy schedules and statements
16 reported only approximately \$10,000 in cash and bank deposits.¹
17 As far as income, the defendant indicated that he and his wife
18 had income of just \$136,807.08 in 2007, and \$86,885 in 2008.²

19 The statements and schedules also reveal that the defendant
20 lost 15 real properties in foreclosure sales between June 2008
21 and March 2009. And, the business interests listed as having a
22 value of almost \$19.0 million on the financial statement are
23

24 ¹ This total does not include approximately \$100,000 in IRAs
25 and an IRC § 529 account. None of these are listed as assets on
the financial statement.

26 ² These totals include all income for 2007 and 2008, whether
27 from employment or other sources, reported in the answers to
28 questions 1 and 2 of the statement of financial affairs filed for
both Mr. and Mrs. Dubinsky.

1 listed on Schedule B as having an "unknown" value.³

2 So, within 28 months of giving his financial statement to
3 the plaintiff, the defendant's financial condition had taken a
4 dramatic tumble - from a \$28 million net worth and substantial
5 liquidity, to a negative net worth and no net income above
6 expenses.

7 Of course, his financial collapse does not necessarily mean
8 that his financial statement was materially inaccurate when it
9 was prepared or, if it was inaccurate, that the defendant knew it
10 was inaccurate.

11 However, comparing the financial statement to the
12 defendant's 2006 federal income tax return reveals that the
13 former was not accurate in many particulars when it was prepared
14 and when it was given to the plaintiff a short time later.⁴

15 First, the financial statement represented that the
16 defendant and his spouse had salaries of \$720,000. The tax
17 return reported total salaries of only \$396,875. But, if
18 commission income of \$68,160 and "supplemental income" of
19 \$216,124 received from one of the defendant's business interests,
20 Trade House USA Inc., are added to the salary reported on the tax
21 return, the defendant's household income rises to \$681,159, only
22 \$40,000 less than he represented on his financial statement.⁵

23
24 ³ A review of the docket reveals no attempt by the trustee to
25 sell any of these interests and businesses, nor any motions by
the debtors seeking to compel their abandonment.

26 ⁴ Perhaps for obvious reasons, the defendant has not
27 asserted that his federal income tax return is inaccurate.

28 ⁵ See Form 1040, Statement 1, Miscellaneous Income, of the
2006 federal income tax return.

1 Second, the financial statement reported gross annual rental
2 income of \$408,000. The tax return, however, reported gross
3 rents of only \$79,514.⁶

4 Third, the financial statement reported dividend income of
5 \$420,000. The defendant's tax return, however, reported a
6 \$534,014 loss from the operation of the defendant's many
7 businesses.⁷ Even if this loss is off-set by the \$1,985 in
8 dividends from investments and a \$53,067 short term gain from the
9 sale of securities reported on the tax return, the defendant had
10 nothing close to the dividend income he represented on his
11 financial statement.⁸ His businesses and investments netted him
12 nothing in 2006.

13 Fourth, the financial statement represented that the
14 defendant had annual interest income of \$184,000 while his tax
15 return for 2006 reported only \$13,258 in interest income.

16 Finally, the defendant's tax return reveals one income
17 source not mentioned on his financial statement. During 2006,
18 the defendant had gambling income \$682,062. Interestingly,
19 according to the return, without this gambling income, the
20 defendant and his spouse had net taxable income of just \$19,533
21 rather than \$701,595. In other words, without gambling income,
22

23 ⁶ See Schedule E, Part I, of the 2006 federal income tax
24 return. In addition to this rental income, the defendant
25 reported on Form 4797 of the 2006 federal income tax return an
\$89,734 gain from the sale of one real property.

26 ⁷ See Schedule E, Part II, of the 2006 federal income tax
27 return.

28 ⁸ See Form 1040 and Schedule D, of the 2006 federal income
tax return.

1 the defendant essentially had no net income in 2006. That is
2 substantially different than the picture painted by the
3 defendant's financial statement which represents approximately
4 \$1.0 million in net income, all of it from investments and
5 salaries.

6 The financial statement also was inaccurate with reference
7 to its representations regarding the defendant's bank accounts.
8 It refers to two accounts at Bank of America. The first
9 reportedly had a balance of \$224,026 on or about mid-November
10 2006, while the second had a balance of \$1,462,734 as of that
11 same time.

12 As to the first account with a balance of \$224,026, the bank
13 statement for the period November 1 through November 30, 2006
14 shows an ending balance of \$402,931.60 and intermediate balances
15 as low as \$117,834.29 and as high as \$538,802.23. However, on
16 November 14, the date the financial statement was signed, the
17 balance was \$129,207.78, not \$224,026. Still, considering the
18 \$183,476.46 beginning balance, the \$402,931.60 ending balance,
19 and the significant amounts flowing in and out of the account,
20 the discrepancy between the account statement and the financial
21 statement is not significant.

22 However, the representation regarding the second account is
23 more problematic. Even though the court received evidence of
24 three other accounts at Bank of America, and even though the
25 combined balance in these accounts as of November 14 was
26 \$1,541,828.50, the three accounts did not belong to the defendant
27 or his spouse. They belonged to a corporate entity in which the
28 defendant had an interest, Trade House USA, Inc., which did

1 business as VLD Realty. One of the accounts was a trust account
2 of some sort. The court received no convincing evidence that the
3 defendant had the use of these accounts for his personal benefit.
4 Nor did the court receive evidence that the defendant somehow
5 included the liabilities of Trade House USA, Inc., dba VLD
6 Realty, to counterbalance his use of its bank accounts on his
7 personal financial statement.

8 The one remaining liquid asset on the financial statement
9 totaled \$303,778 and consisted of marketable securities. This
10 amount corresponds almost exactly with a security trading account
11 maintained by the defendant and his spouse at Scottrade. A
12 statement for the period October 1 through October 31, 2006 shows
13 a beginning balance of \$303,778.68. The ending balance, however,
14 was substantially less, only \$190,358.68.

15 The court concludes that the financial statement given by
16 the defendant to the plaintiff materially misstated his and his
17 spouse's incomes and their liquid assets.

18 The court does not believe the defendant's assertion that he
19 did not realize his financial statement was inaccurate when it
20 was given to the plaintiff. This assertion is not credible nor
21 plausible.

22 First, the magnitude of the discrepancies between his
23 financial statement and his tax return convince the court that he
24 must have known that his financial statement was not accurate,
25 both when it was prepared and when it was given to the plaintiff.

26 Second, the financial statement not only misrepresented
27 amounts, it misrepresented the defendant's ownership of bank
28 accounts (it included corporate accounts as personal accounts)

1 and it omitted any reference to his gambling income.

2 Third, the defendant is an experienced and astute
3 businessman. He was an investor in many large businesses, he
4 owned many rental properties, and he operated many other closely
5 held businesses. In short, he was business savvy and no stranger
6 to credit transactions. He knew his financial condition when he
7 gave his financial statement to the plaintiff.

8
9 II

10 The complaint asks that the plaintiff's state court judgment
11 against the defendant be declared nondischargeable pursuant to
12 section 523(a)(2)(B).

13 In order to obtain such a declaration, the plaintiff must
14 prove by a preponderance of the evidence that the defendant
15 incurred a debt by the use of a (1) written statement, (2) that
16 was materially false, (3) respecting the defendant's financial
17 condition, (4) that the defendant caused to be made or published
18 with the intent to deceive the plaintiff, and (5) on which the
19 plaintiff reasonably relied.

20 There is no dispute that the financial statement was a
21 written document respecting the defendant's financial condition.
22 There also is no dispute that the defendant authorized his agent
23 to give the plaintiff the financial statement in connection with
24 the negotiation of the sublease and a demand that the defendant
25 guarantee ATO's financial performance of the sublease.

26 At trial, the defendant argued that the misrepresentations
27 were not materially false and, if they were materially false, the
28 plaintiff's reliance on the financial statement was not

1 reasonable. The court rejects both arguments.

2 The defendant's trial brief correctly notes that it is not
3 enough to show that the financial statement is factually
4 incorrect. See First Intertate Bank of Nevada v. Greene (In re
5 Greene), 96 B.R. 279, 283 (B.A.P. 9th Cir. 1989). To be
6 materially false, the statement must "paint a substantially
7 untruthful picture of the financial condition by misrepresenting
8 information of the type which would normally effect the decision
9 to grant credit." Id.

10 The defendant believes that his financial statement did not
11 materially misrepresent his overall financial condition. While
12 the statement included bank accounts that did not belong to the
13 defendant or his spouse, substantially over-stated his household
14 income, and omitted any reference to gambling income, these
15 departures from the truth were immaterial given the defendant's
16 \$39 million in total assets and \$28 million net worth.

17 However, the plaintiff was seeking assurance that ATO or the
18 defendant would be able to pay timely a relatively modest amount
19 of rent (no more than approximately \$141,086). To than end, the
20 plaintiff's logical concern was with the defendant's liquidity -
21 his ability to timely pay should ATO be unable to do so. The
22 misrepresentations in the financial statement went to the
23 defendant's liquidity. The defendant's real estate holdings and
24 his interests in closely held businesses were less relevant and
25 helpful to ATO's quest for a tenant who was able to pay timely
26 rent than were the defendant's bank balances and incomes.

27 Viewed in this light, the financial statement was materially
28 inaccurate. The financial statement represented that the

1 defendant and his spouse had \$1.0 million in net income, all of
2 it from investments and salaries. In fact, without the
3 undisclosed gambling income, he had virtually no income in 2006.
4 And, while the defendant did hold one bank account at Bank of
5 America with a balance of approximating the \$224,026 represented
6 in the financial statement, his other liquid assets were not as
7 represented. He was not the owner of the other Bank of America
8 account(s) with a balance of \$1,462,734, and his securities
9 account had a balance of \$190,358.68, not \$303,778. The
10 discrepancy, approximately \$1.0 million, cannot be dismissed as
11 irrelevant for a debtor with no net income and annual expenses of
12 approximately \$700,000.

13 Of course, the defendant did have other income in 2006. He
14 won approximately \$700,000 in his gambling pursuits but failed to
15 disclose that income. This nondisclosure also was material. It
16 is difficult to imagine that the plaintiff, looking for the
17 security of liquid and solvent guarantor, would have considered
18 the defendant a good risk if his solvency and liquidity hinged on
19 his card playing prowess.

20 Although not necessary to its conclusion that the financial
21 statement was materially false, the court adds that it does not
22 believe its representations regarding the value of the
23 defendant's other assets and his net worth. As noted above,
24 within three months of giving the statement to the plaintiff, ATO
25 had defaulted on the lease and the defendant refused to honor his
26 guarantee. This quick default was followed in short order by the
27 foreclosure of most of the defendant's rental properties, the
28

1 filing of 28 lawsuits against the defendant and his spouse,⁹ and
2 a 2009 chapter 7 petition that admitted to a negative net worth
3 in the millions of dollars.

4 The court is convinced that the plaintiff actually relied on
5 the financial statement when deciding to let the property to ATO.

6 Whether its reliance was reasonable must be judged in light
7 of the totality of the circumstances of this case. See e.g., In
8 re Cohn, 54 F.3d 1108 (3rd Cir. 1995). The court concludes that
9 the plaintiff's reliance on the defendant's financial statement
10 was reasonable.

11 First, the financial statement was one that had been
12 presented to Bank of America in connection with the defendant's
13 recent successful application for a loan. In other words, it had
14 been given to a sophisticated lender in connection with a
15 substantial loan which the defendant had used to acquire real
16 property and make construction improvements. What better
17 recommendation than the fact that a sophisticated lender like
18 Bank of America had found the defendant creditworthy?

19 Second, as represented in the financial statement, the
20 defendant's income and investments greatly exceeded the debt
21 being guaranteed. Given this more than comfortable margin, the
22 court cannot fault the plaintiff for not asking for further
23 documentation of the defendant's finances.

24
25 ⁹ In response to Question 4a of the Statement of Financial
26 Affairs, the defendant and his spouse listed 28 lawsuits in which
27 they are named as defendants. Judging from the case numbers and
28 the fact that the defendant reported that only two of these suits
had been concluded when the chapter 7 petition was filed in 2009,
these suits were filed between 2006 and 2009.

1 Finally, the court can discern nothing from the face of the
2 financial statement, or from the other facts made known to the
3 plaintiff when negotiating the sublease, that should have alerted
4 the plaintiff to further investigate the defendant's financial
5 condition.

6 The defendant also argued that he did not intentionally
7 deceive the plaintiff. However, the magnitude the
8 misrepresentations concerning the defendant's income and liquid
9 assets, the almost immediate default under the sublease and the
10 defendant's failure to even attempt to honor his guarantee, the
11 defendant's financial deterioration immediately after giving his
12 guarantee, and the defendant's financial sophistication, all
13 convince the court that the defendant knew he was not being
14 truthful and that he intended to deceive the plaintiff.

15
16 III

17 For the foregoing reasons, the court will enter a judgment
18 for the plaintiff. As the prevailing party, the plaintiff will
19 recover its costs of suit and fees.¹⁰

20 A separate judgment will be entered.

21 Dated: 9 Feb. 2011

22 By the Court

23 

24 _____
25 Michael S. McManus, Judge
26 United States Bankruptcy Court

27 _____
28 ¹⁰ The guarantee includes an attorneys' fee provision for
legal services incurred in its enforcement.

UNITED STATES BANKRUPTCY COURT
EASTERN DISTRICT OF CALIFORNIA

CERTIFICATE OF MAILING

The undersigned deputy clerk in the office of the United States Bankruptcy Court for the Eastern District of California hereby certifies that a copy of the document to which this certificate is attached was mailed today to the following entities at the addresses shown below or on the attached list.

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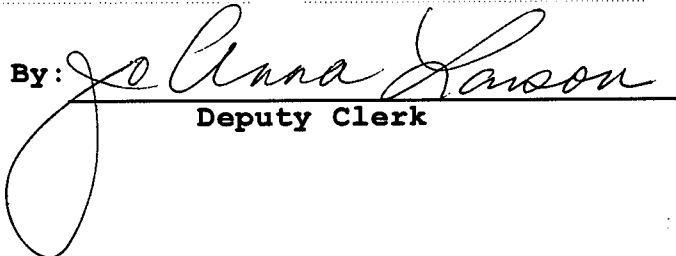
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DATED: 2/10/2011

By:


Deputy Clerk

EDC 3-070 (Rev. 6/28/10)